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TAGS: [ECON](#) [IT](#) [ITALY](#) [NATIONAL ELECTIONS](#)

SUBJECT: The Economy, But Not Economic Reform, Begins to Dominate Italian Election Campaign

Ref: A. ROME 725

[B](#). ROME 798
[C](#). NAPLES 102
[D](#). ROME 864
[E](#). ROME 863

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[1](#). (SBU) Summary and Comment: Italy's electoral campaign has begun to focus almost exclusively on incumbent Prime Minister Silvio Berlusconi's Achilles heel: the economy. Center-left challenger Romano Prodi threw Berlusconi on the defensive during a nationally televised debate March 14 that focused almost exclusively on economic issues. Berlusconi delivered a weak performance in which he tried, unconvincingly, to paint a rosy picture of his accomplishments and of the Italian economy. In turn, the center-left has offered a series of populist proposals to capture voters disillusioned by the poor economy. What is missing from this campaign, however, are serious proposals for structural economic reform necessary for Italy to remain a strong and reliable ally actively engaged abroad. End summary and comment.

E l'Economia, Stupido.

[2](#). (SBU) Italy's poor economic health has emerged as the key issue in its national elections April 9-10. Throughout January and February, incumbent Prime Minister Silvio Berlusconi and his Forza Italia party kept the debate focused on the appropriateness of his campaign tactics and other issues favorable to him (Ref A) to avoid a meaningful discussion of economic issues. Berlusconi's handlers recognize that economic themes are his weak point, since most Italians polled consider themselves worse off now than five years ago. However, the moderators in the first Prodi-Berlusconi debate on March 14 limited the discussion almost entirely to economic themes in a format that did not permit Berlusconi to change the subject. Since then, the debate has almost entirely shifted to economic issues, and Berlusconi's occasional gaffes.

Berlusconi: The Economic Record

[3](#). (SBU) Berlusconi has the difficult task of defending his management of Italy's dismal economy. The Italian business community expected great things from Berlusconi following his election in 2001. They have been disappointed. Italy's economy has stagnated over the last five years, averaging just 0.6 percent GDP growth per year since 2001, compared with 1.5 percent for the euro area, 1.6 percent for France, and 2.3 percent for the UK.

[4](#). (SBU) The center-right government, however, has not been a complete wash for the Italian economy, as Berlusconi's critics charge. The coalition improved labor flexibility with the 2003 "Biagi Law" (which made it much easier to hire workers on temporary contracts) and regularized 700,000 formerly illegal immigrant workers. The Biagi Law and the legalization helped lower Italy's nominal unemployment rate from 9.1 percent in 2001 to 7.7 percent in 2005. The center-right also enacted modest pension reforms, gradually raising the retirement age for most male workers from 57 to 60 starting in 2008, and eventually to 62 in [2014](#). Finally, Berlusconi's coalition passed income tax cuts in 2003 and 2005 that amount to 350-500 euro per year for the average Italian family.

Half Measures Frustrate Business.

15. (SBU) While Berlusconi has attempted to grapple with some of Italy's fundamental problems, the fixes he has managed to implement have been the kind of half measures that please no one. The pension reform, by raising the retirement age only modestly over such a long period, does little to ensure the long-term sustainability of the system; yet, it has cost the center-right support among working Italians. The tax cuts, aimed at Italy's struggling middle class, have been offset by price increases for utilities and other government services. Our business contacts frequently grumble that Berlusconi only uses his political capital for the things--such as decriminalization of false accounting or relaxation of media regulation--that benefit his personal legal and business interests.

16. (U) As a result, Italy's business leaders--led by FIAT Chairman Luca Cordero di Montezemolo, who also heads Italy's main employer association, Confindustria--have become Berlusconi's harshest critics. Relations between Berlusconi and Confindustria reached a nadir at the associations' annual meeting March 18 when the Prime Minister lashed out at Montezemolo and other association leaders, by saying their negativity was undermining his campaign. Forza Italia campaigners claim this confrontation helped Berlusconi with small business owners unrepresented by Confindustria. True or not, it certainly made it clear that Berlusconi does not have the strong backing of industry that he once enjoyed.

The Optimist Versus the Cassandra

17. (U) Berlusconi's primary tactic, one that worked successfully for him in the 2001 election, is to exude confidence and optimism on the economy. Berlusconi's campaign slogan, "The left says everything is going badly, let them lose!", sums up his approach to this election.

18. (U) The left is using growing economic anxiety to attack the Berlusconi administration for increasing job insecurity and for presiding over a drop in household spending power that coincided with the switch to euro coins and banknotes. Prodi has embraced the "Cassandra" label given to him by Berlusconi's supporters. "They forget that Cassandra always told the truth," Prodi commented to the Corriere della Sera newspaper March 7, "even if she was condemned by the gods never to be heard."

Election Issue #1: Jobs and Income

19. (U) The heart of both the center-right and center-left economic platforms is reducing labor costs to boost income, spur greater employment, and counter declining worker productivity. Prodi has pledged to reduce social security contributions by five percent--three percent from the share paid by workers themselves and two percent from the share paid by employers. Prodi would pay for these reductions (and for his proposed increases in social spending outlined below) by raising the capital gains tax rate from 12.5 to 20 percent.

10. (SBU) Berlusconi's platform, meanwhile, calls for a three-percent cut in contributions--one percent for workers, two percent for firms. Unlike the center-left, the center-right alliance has not explained how they would pay for their proposed reduction in social security contributions. Furthermore, the center-right is attacking Prodi's plan to raise taxes, by saying this will hurt average Italians, stifle Italy's economic recovery, and lead to capital flight. (Berlusconi's tax amnesties may have coaxed some off-shore money back to Italy, but they create a moral hazard and stimulate further tax evasion.)

11. (SBU) Comment: A capital gains tax increase may prove politically risky for the center-left. Though falling, Italy's savings rate remains at 12.7 percent, meaning many average citizens hold bonds and other investments that would be subject to these higher taxes. Also, some economists warn that a higher capital gains tax will force the GOI to raise returns on government bonds, potentially gobbling up any revenue gain in higher debt service. End comment.

...And More Welfare.

12. (U) As part of its platform for boosting family income, the center left promises additional assistance for child care and government payments of euro 2,500

per year for each child under three. This is many times more generous than childbearing subsidies enacted under the center-right government, which included an income-dependant, one-time-only lump sum payment of euro 1,000 for each newborn.

¶13. (U) Berlusconi's social platform, meanwhile, focuses on retirees. The center-right promises that it will raise the minimum state pension from euro 600 per month to 800 for Italy's least-well-off senior citizens. This measure is expected to produce a further (unfunded) burden of up to euro 7.2 billion per year on the national budget. Promising pension increases worked for Berlusconi in 2001, and the Prime Minister delivered by increasing minimum rates to euro 600/month, though the increase was limited to pensioners over 70 with no other source of income--a group that included 1.4 million of the 7.2 million people then receiving minimum state pensions. Future pension increases will likely carry similar limitations.

How and How Much to Help the South

¶14. (U) Many of the key swing regions in this elections, including Puglia, are located in the South (the "Mezzogiorno"); and the center-left hopes to convince voters there that it will be more generous than Berlusconi. The center-left promises a slew of aid for government services, anti-mafia campaigns, infrastructure, education, research and development, transportation, and support to low-income families. The center-left also pledges additional tax incentives for companies willing to invest in the Mezzogiorno. Berlusconi's southern strategy is hobbled by the presence in his coalition of the Northern League, which has vociferously opposed government hand-outs for the South. The center-right platform focuses primarily on improving southern infrastructure, specifically by constructing the Straits of Messina Bridge to connect Sicily with mainland Italy. (See Refs B, C.)

Dancing Around Reform

¶15. (SBU) While economic issues have taken center stage in this campaign, the question of structural reform has not. In a recent conversation with Econoff, Marcello Messori, an economic advisor to the center-left, was highly critical of the lack of straight talk in the current campaign. Both sides, he observed, are focusing on relatively minor economic issues, such as social security contributions and child care, rather than addressing the need for fundamental economic reform. Neither candidate, he said, is honestly telling voters that Italy, faced with growing competition from China and other low-cost producers, must make a painful shift from manufacturing to a service-based economy. The center-left's unstated goal, Messori said, is to improve Italy's welfare system as a way of easing this transition. Messori acknowledged, however, that Prodi's coalition is far from united, with the hard-left coalition members, such as the Rifondazione Comunista, stubbornly hostile to economic liberalization.

Comment

¶16. (SBU) As Italy's richest businessman, Berlusconi was swept into office in 2001 under the promise to return Italy to its former status as a first-tier economy. Five years later, Italians are openly speaking about becoming the "next Argentina"--i.e., a once-great economic power that slid into third-world status through persistent debt, corruption, and mismanagement.

¶17. (SBU) The reluctance of both sides to directly address Italy's fundamental economic problems is, in our view, a defining characteristic of this campaign. Though Italy is falling further behind the rest of Europe (not to mention East Asia and the United States), both the center-left and center-right have concluded that tough talk about Italy's economic ills is no way to win an election.

¶18. (SBU) At every opportunity, the Embassy stresses to Italian audiences the need for the next GOI, whether led by Berlusconi or Prodi, to improve Italy's economic performance and competitiveness. Without a more dynamic economy, Italy will have increasing difficulty playing a strategic, active role in the G/8, meeting its international commitments, and remaining an active partner with the United States in Iraq, NATO, Afghanistan, and future world challenges. End comment.

